

Congress of the United States  
CONGRESSIONAL OVERSIGHT PANEL

## Opening Statement of J. Mark McWatters

### Congressional Oversight Panel Hearing on Commercial Real Estate

February 4, 2011

Thank you Senator Kaufman and welcome to our distinguished witnesses.

There is little doubt that much uncertainty continues to exist within the commercial real estate, or CRE, market. In order to suggest a solution to the challenges facing the CRE market it is critical that we thoughtfully identify the sources of the underlying difficulties. Without a proper diagnosis it is likely that we may craft an inappropriately targeted remedy with adverse unintended consequences.

Broadly speaking, it appears that today's CRE industry is faced with both an oversupply of over-leveraged CRE facilities *and* an undersupply of prospective tenants and purchasers. In my view, there has been a remarkable decline in demand for CRE property over the past two years and many potential tenants and purchasers have withdrawn from the CRE market not simply because rental rates and purchase prices are too high due to the excess debt loads carried by many CRE properties, but because their business operations do not presently require additional CRE facilities. Over the past few years while CRE developers have constructed new office buildings, hotels, multi-family housing, retail facilities and industrial properties with an excess of cheap, short-term credit, the end users of such facilities have suffered the worst economic downturn in several generations. Any posited solution to the CRE problem that focuses only on the oversupply of over-leveraged CRE facilities to the exclusion of the economic difficulties facing the end users of such facilities appears less than likely to succeed. The challenges confronting the CRE market are not entirely unique to that industry, but, instead, are indicative of the systemic uncertainties manifest throughout the larger economy.

In order to address the oversupply of over-leveraged CRE facilities, developers and their creditors are currently struggling to restructure and refinance their portfolio loans. In some instances creditors are acknowledging economic reality and writing their loans down to market value with, perhaps, the retention of an equity participation right. In other cases lenders and borrowers are merely "kicking the can down the road" by refinancing problematic credits on a short-term basis at favorable terms so as to avoid loss recognition and capital impairment for the lenders and adverse tax consequences for the borrowers. While each approach may offer assistance in specifically tailored instances, neither addresses the underlying reality of too few tenants and purchasers of CRE facilities.

## Congressional Oversight Panel

Until small and large businesses regain the confidence to hire new employees and expand their business operations it is doubtful that the CRE market will sustain a meaningful recovery. As long as businesspersons are faced with the challenges of rising taxes and increasing regulatory burdens, it is less than likely that they will enthusiastically assume the entrepreneurial risk necessary for protracted economic expansion and a robust recovery of the CRE market. It is fundamental to acknowledge that the American economy grows one-job and one-consumer purchase at a time, and that the CRE market will recover one-lease, one-sale and one-financing at a time. With the expanding array of less than friendly rules, regulations and taxes facing businesspersons and consumers we should not be surprised if businesses remain reluctant to hire new employees, consumers remain cautious about spending, and the CRE market continues to struggle.

The problems presented by today's CRE market would be easier to address if they were solely based upon the oversupply of over-leveraged CRE facilities in certain well delineated markets. In such an event, a combination of thoughtful—yet no doubt painful—restructurings, refinancings and foreclosures would result in the material de-leveraging and re-pricing of troubled CRE properties. Unfortunately, even those CRE properties that are appropriately leveraged and priced must also assimilate a drop in demand from prospective tenants and purchasers who have suffered a reversal in their business operations and prospects.

Although some progress has been made, the Administration could further assist the recovery of the CRE market—as well as the broader U.S. economy—by sending an unambiguous message to the private sector that it will not directly or indirectly raise the taxes or increase the regulatory burden of CRE market participants and other business enterprises. Without such action, the recovery of the CRE market will quite possibly proceed at a sluggish and costly pace with further adverse consequences for those financial institutions and investors that hold CRE loans and commercial mortgage-backed securities.

Thank you for joining us today and I look forward to our discussion.